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ANALYSIS OF AIR FORCE AWARD FEE AND AWARD
TERM CONTRACT IMPLEMENTATION

By

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Preface

This project was undertaken because of a keen interest in award fees and personal experience throughout my short 12-year career in U.S. Air Force contracting. Award fees existed when I entered the career field so they were not a new vehicle or revolutionary idea for me as compared to professionals who had been performing contracting for years. They were just another tool to me. However, no matter where I went, I was always confronted with anecdotal evidence of significant problems in implementing and administering award fee contracts.

When given the opportunity to explore and research an issue of benefit to the Air Force at Air Command and Staff College I chose this topic because of its currency and my curiosity. The newest incentive, award term, was invented and used at my previous assignment at Kelly AFB. Award term is so new and so close to award fee that it has inspired significant review and discussion throughout the acquisition community. I hope that this review will provide insight to current projects under way at Air Staff and other levels, and assist those struggling to execute effective and efficient contracts every day.

I'd like to extend my thanks and appreciation to the contracting professionals, Fee Determining Officials, and members of industry who contributed their candid views, experiences and opinions to this effort. Finally, thanks to my research advisor Lt Col Wishnietsky whose astute guidance and significant insight shaped this product.

Abstract

The use of incentive contracts, particularly award fee and award term contracts, has increased significantly in recent years. This research examined concerns that these incentives were not being implemented as originally intended. Specifically the research answered whether or not changes are necessary to improve the effectiveness of these tools and whether they actually incentivize the wrong behaviors in industry.

Research was conducted by reviewing background information from government regulations and professional organizations to document the history of these incentives. Prescriptive guidance was then compared to actual application of these contracts in an attempt to identify disconnects. Actual application was determined by reviews of numerous published audits and guides, as well as personal interviews with government and industry personnel.

The research concluded that the contracts were not being implemented as intended, and improvements need to be made to procedures and processes used by government agencies. Additionally, the research concluded that award fees do actually incentivize the wrong behavior in industry by motivating them to increase their risk through lower proposed profit margins.

However, the effects of the above conclusions were less detrimental than anticipated. It was concluded that the improvements to procedures used in administration of award fee contracts would improve efficiency, not necessarily effectiveness. Also, the increased risk was mitigated by complex award processes and the award fee process itself. Therefore, the increase in risk did not point to a clear increase in contract failures as a result of incentivizing the wrong behaviors.

Chapter 1

Introduction

The use of incentive contracts by federal agencies, including the United States Air Force, has increased significantly in the last 20 years. Incentives are specified rewards (in time or money) provided to motivate contractors to achieve specific results or quality standards. As the use of incentive contracts increases, the population of professionals in both the public and private sector that has experience with these contracts also increases. This increase in experience has promulgated both discourse and debate among the professional acquisition community regarding the benefit and proper implementation of incentive contracts. Recent professional discourse includes anecdotal experiences centered on whether or not incentive contracts are implemented properly in the Air Force. Specifically, there are concerns that award fee incentives, or the newest hybrid Award Terms, are not being implemented in a manner consistent with their original intent. Also, it is possible that the application of these instruments to motivate contractors could incentivize the wrong behavior and be detrimental to acquisition initiatives.

Research Question

Are Air Force Award Fee/Award Term contracts implemented in a manner that is consistent with their intent? If not, are changes necessary or possible to improve the effectiveness of this contract tool?

Problem Background and Significance

The Air Force has used numerous types of incentives in contracts to motivate contractors to either save money or perform at a level considered above satisfactory. Award Fee contracts, through which contractors are evaluated and granted additional money for excellent performance, is one type of incentive popular within the Air Force acquisition community. Its popularity has spawned a new derivative, Award Term, in which contractors are granted contract extensions in lieu of money. The purpose of this research is to evaluate the use of these incentive contracts, determine if their implementation achieves the intended objective, and recommend how they can be effectively used throughout the Air Force. The research evaluated original guidance and intent of the award fee/term contract and compared that to how they are currently implemented. Input was solicited from field acquisition experts, customers, and industry to evaluate what impacts the award fee/term process has on each of them and to make recommendations for future use of these tools.

Methodology

Research was pursued via the Internet, library sources, government regulations, and professional organizations to document the background and evolution of this contract method. Prescriptive guidance in policy and regulations was then compared to actual operational application of award fee incentive contracts in an attempt to identify disconnects. Actual application was derived from reviewing audits and primary source data collection in the form of interviews or feedback directly from personnel involved in implementing award fee/award term contracts. Feedback was evaluated from those closest to the implementation to determine if changes might be necessary to improve the process or reverse improperly incentivized behavior.

Structure

Chapter I of this paper introduces the research problem, explains the significance and outlines the limitations and assumptions of the study. Chapter II explains the evolution and intent of award fee contracts using government sources and the professional body of knowledge. Chapter III examines studies, audits and analyses in an attempt to locate current or past problems with the implementation of this type of contract. Particular attention is given to trends in findings that validate the challenges of implementing award fee/term contracts. Chapter IV includes an analysis, from primary source data, to validate whether disconnects exist between guidance and implementation and whether the process can benefit from some improvement. Finally, conclusions and recommendations are made to benefit future users of this contract method.

Limitations of the Study

Although award fees can be added to many types of contracts, both cost and fixed price, this study limits its focus to those in the fixed price realm. Though processes are almost identical for determining fees, extrapolation of data from this study to any contracts other than fixed price award fee contracts is not recommended. An additional limitation of this study is its scope. While a significant effort was made to explore a wide variety of data sources from industry and government, the majority of the data analyzed was compiled from sources dealing with United States Air Force contracts. Even more specifically, the data received was primarily from sources dealing in service or maintenance type contracts as opposed to manufacturing or production. Although it can be assumed that general findings in this study would be applicable to other fixed price contracts, the findings and recommendations herein cannot be considered statistically representative of all Department of Defense (DoD) or even Air Force contracts with award fees.

Finally, the discussion of Award Term contracts is based on very little actual application, as this contract is so new it is not even covered by federal regulations yet. Therefore, it must be assumed that policies and procedures for use of this new incentive will evolve rapidly as federal agencies begin to prescribe guidelines for its use.

Definitions and Assumptions

As stated above, award fees can be used in cost contracts in which contractors are reimbursed their actual costs, or in fixed price contracts in which the contractor is guaranteed a fixed price no matter what his costs are. Additionally, award fees can be used in conjunction with fixed fees. For example, a contractor can be granted his costs, plus a fixed fee for just meeting standards, and then an award fee on top of that depending on how far he exceeds those standards. Further definition of terms can be found in the glossary. For purposes of this study, the term award fee will refer to contracts that are fixed price in nature only, and do not include a fixed fee. The award fee contracts referred to have a fixed price, and an available pool of dollars, which the contractor may earn in any percentage from 0-100 based on the level of his performance.

Chapter 2

History of Award Fee Incentives

This kind of contract gives a company a definite incentive to cut its costs. In fact, the heart of the contract is the conviction that American business can perform miracles of low cost production if it is given a profit incentive for doing so.

—Navy Under Secretary Forrestal

Attempts by federal agencies to motivate contractors using incentives reach back to the American Civil War. *Monitor*, the U.S. Navy's ironclad ship was bought using a contract that included a performance incentive.¹ Another famous use of contract incentives was between the Army Signal Corps and the Wright Brothers for the country's first aircraft buy. The contract included a performance incentive based on flight speed. A flat price was established of \$25,000 for a 40 mph flight, but the contract also included positive and negative incentives for actual speed obtained. The aircraft flew 42 mph and the brothers received a \$5,000 incentive payment.²

Incentives were also common during both World Wars. Navy contracts with Bethlehem Steel for shipbuilding in World War I included incentive fees for performance and capital investment.³ During mobilization for World War II the preference for competitive bidding was again overcome by the urgency of the times. The War Production Board's Directive No 2 of March 3, 1942, stated that formally advertised bid procedures were not to be used in war contracts. Negotiation was to be used (as it was in other mobilizations). But the directive also established three criteria for contracts: (1) speed of delivery; (2) conservation of superior facilities for the more difficult items of production; and (3) placing contracts with firms needing

the least amount of additional machinery and equipment.⁴ This need for speed encouraged the separate departments of the Army and Navy to break new ground in contract terms. The War department developed an “evaluated-fee” contract similar to the cost plus fixed fee construction contracts of World War I, except part of the fee would vary depending on the contractor’s performance. The Navy’s Bureau of Ships also modified the cost plus fixed fee (CPFF) contract, so that a portion of the fee was firm and the rest was paid as a bonus for achieving cost savings. This contract appeared in 1943 in large ship building programs and some ordnance items.⁵ These innovations were the precursors of the award fee contract that is so popular today. Under Secretary of the Navy Forrestal, whose quote appears above, was a grand proponent of incentive contracts and in 1943 the Navy tried to convert as many of its contracts as possible into incentive contracts. However, the initiative received lackluster support from industry because of their inexperience with and frequent government contract changes. Production experience was low so contractors had difficulty estimating costs, and government changes and interference often interrupted delivery schedules. Consequently contractors were cool to incentives because they did not want their profit tied to changing goals. The lesson learned was that incentive contracts can be powerful but must be used at the right time and place and under the right conditions to be truly effective. NASA would successfully reintroduce this incentive twenty years later.

Award Fee Comes of Age

A convergence of government forces in the 1960s led to the development of the award fee process currently used in government contracting. Defense Secretary Robert S McNamara, who served under Presidents Kennedy and Johnson, had a tremendous effect on defense procurement. McNamara, a graduate of Harvard’s Graduate School of Business Administration and a statistician for the Army Air Corps in WWII, was determined to upgrade procurement practices

with modern management techniques. McNamara put a halt to cost based contracts. He believed they encouraged waste because they did not link profits to how well the job was done. During his term as Secretary the percentage of military procurement dollars awarded by cost plus fixed fee contracts fell from 39 percent in 1960 to 14 percent in 1964. Conversely, fixed price and fixed price incentive dollars awarded rose from 45 to 55 percent in the same period.⁶

During the early 60s, government and private officials were independently considering award fee contracts. In 1961 professor Frederic Scherer of Harvard University proposed reviews after performance while working for the Harvard Weapons Acquisition Research Project.⁷ However, NASA and DoD officials created the first award fee contracts that are common today.

Although NASA is largely credited with creating the award fee contract, both NASA and the Navy issued contracts with award fee provisions during 1962. The Navy issued a contract for logistics operations support at Kwajalein Island⁸ that year which included provisions for award fees. But NASA issued a contract in October of 1962, which provided for the research and development of a nuclear powered rocket engine. A second NASA contract, issued in Jan 1963, covered the operation, maintenance, and engineering services for the Mercury Manned Space Flight Network.⁹ NASA went from one contract in 1962 to thirty four by 1964. By the beginning of 1967 NASA was managing some 200 contracts with incentives.¹⁰

The Air Force was reluctant to jump into the award fee game and didn't issue its first contract until 1964. After Electronic Systems Division issued the contract, no more were accomplished until late 1969, due to an unwritten policy against subjective incentives.¹¹

Throughout the 60s, NASA and the Navy used award fee contracts extensively while the Air Force and Army shunned them. However, the Air Force expanded their use in the 70s, as then Secretary Seamans mandated their use on major programs like the B-1 and F-15.¹²

Growth of Use

Throughout the 1980s and 1990s the use of award fee contracts increased exponentially throughout the DoD and Air Force. Historically reserved for large program contracts as evidenced above, award fee contracts expanded into the smaller dollar arenas and their use grew widely among installation level service and maintenance contracts. In fact, one of the largest users of award fee contracts on a consistent basis is the Air Education and Training Command (AETC). This command contracts out to private industry almost all the aircraft maintenance and many base support services conducted at their bases. Due to the rapidly increasing use among base level installations, the Air Force tasked the Air Force Logistics Management Center (AFLMC) to author a guide on award fee contracts, which was published in 1988.¹³ The promulgation of this contract type among base level offices and program offices has caused the AFLMC and the Air Force Audit Agencies to do repeated reviews of implementation throughout the last ten years. These reviews will be covered in a subsequent section, but it is clear that award fee use has grown substantially among Air Force contracting agencies.

The Next Step in Evolution - Award Term

The award-term incentive is a genuine innovation, and one with great potential to forever alter the landscape of Government service contracting.

—Vernon J Edwards¹⁴

What is it?

The award-term contract is the newest incentive in government contracting. It was first used in 1997 and is not yet covered in the Federal Acquisition Regulation (FAR). It is modeled after the award fee incentive described above and in FAR 16.405-2, but instead of rewarding a

contractor for excellent performance with additional money, it rewards the contractor by extending the contract term without competition. Under an award-term incentive a government team monitors and evaluates the contractor's performance and reports their findings to a government term determining official (TDO). The TDO decides whether the contractor's performance was good enough to merit an extension. The award term incentive was the inspiration of Tommy Jordan, a senior U.S. Air Force civilian employee at Kelly Air Force Base. Its first use was on a contract that the Air Force's Aeronautical Systems Center awarded to the McDonnell Douglas Corporation in October of 1997 for F-15C aircraft simulation services. The contract has a seven-year base period, which can extend to 15 years with excellent service.¹⁵ Since that first use, at least 25 programs have included award term incentives, including the \$10.2 billion public/private competition at Kelly AFB for aircraft engine maintenance.

Award-term contracts reward the contractor with a legal entitlement to a contract extension. In the last three years, agencies have used award-term incentives to acquire a variety of services, including technical and logistics support, laundry and dry cleaning, depot-level maintenance, aircraft maintenance, grounds maintenance, janitorial services, real property maintenance and repair, and training.¹⁶ The incentive is being used with several contractual configurations such as fixed-price, cost-reimbursement, indefinite-delivery/indefinite quantity, and requirements. The Air Force, NASA, the Naval Facilities Engineering Command, the Naval Sea Systems Command, the Army's Ft. Drum in New York, and the General Services Administration have all conducted or plan to conduct acquisitions with award-term incentives.

Future Application

As of March 1990, the Air Force identified 114 active installation-level award fee contracts with a total contract value of about \$2.6 billion (including multiyear options) and potential award

fees totaling \$145 million.¹⁷ Between fiscal years 1993 and 1998 the Air Force Awarded commercial activity contracts totaling \$5.8 billion with award fee pools totaling \$230 Million.¹⁸

Although no one can speak with certainty regarding the future, it appears that use of award fee and award term contracts will continue to increase. The most likely category of acquisition for these incentives to grow is in competitive sourcing contracts and public/private competitions. There are two reasons for this likelihood. First, these types of contracts lend themselves conveniently to qualitative review, which was the intent of this type of incentive, because they are service oriented and not well suited to objective (vs. subjective) evaluation criteria. Quality is inherently a subjective determination in performance of services. Second, these competitive sourcing or public/private competitions are excruciatingly painful for the acquisition community to conduct. They take enormous time and effort to complete (frequently one to two years). Therefore, award term contracts should flourish because the benefits to organizations are great if they can extend the time between competitions. If the contractor is performing well, the agency can use its manpower more efficiently on other acquisitions rather than conducting re-competitions because the minimum time is up. This more closely mirrors the private sector in which long term relationships with satisfactory performers are preferred. Additionally, it is also quite likely that DoD's competitive sourcing and public/private competition efforts will continue to grow or at least remain status quo as agencies search for the most efficient way to use available resources. These efforts will continue to be pursued where efficiencies and cost savings can be gained without impacting mission effectiveness.

Finally, it is currently the objective of DoD acquisition agencies to use incentives as much as possible. In 1997, the government iterated a policy encouraging agencies to use incentives "to the maximum extent practicable" when contracting for services."¹⁹

Notes

¹ R.F. DeMong, “The Effectiveness of Incentive Contracts: What Research Tells Us,” *National Contract Management Quarterly Journal*, vol. 12, no. 4 (1978): 12.

² Ibid, 12.

³ Nash, *Incentive Contracting*, (Washington, DC: The George Washington University Government Contracts Program, 1963), 3.

⁴ James F. Nagle, *A History of Government Contracting* (Washington D.C.: George Washington University), 432.

⁵ John Perry Miller, *Pricing of Military Procurements*, (New Haven: Yale University Press, 1949), 144.

⁶ James F. Nagle, *A History of Government Contracting* (Washington D.C.: George Washington University), 494.

⁷ Frederic M. Scherer, *The Weapons Acquisition Process: Economic Incentives* (Boston: Harvard University Press, 1964), 327.

⁸ Kwajalein is a tiny island in the Ralik chain of the Marshall Islands. It has been home to many military and NASA uses including radar and space tracking

⁹ National Aeronautics and Space Administration. Cost Plus Award Fee Contracting Guide, NHG 5104.4 Washington: US Government Printing Office, August 1967, 6.

¹⁰ Vernon Edwards, *Award Term: the Newest Incentive*, Contract Management, Feb 2001, National Contract Management Association, 44.

¹¹ Brown, 5.

¹² Ibid, 7.

¹³ Air Force Logistics Management Center, Base Level Award Fee Guide, Project Number LC850705, Air Force Logistics Management Center, 1988.

¹⁴ Vernon Edwards is a recognized expert in federal contracting. He is a writer, lecturer, and consultant in federal acquisition with wide and varied experience in contracting for the Air Force, NASA, and Department of Defense. He has written numerous articles for professional journals, and books dealing with Federal Acquisition. Mr Edwards also served as a member of the faculty of the government contracts programs of The George Washington University School of Business and Public Management, and the George Washington University School of Law.

¹⁵ Vernon Edwards, *Award Term: the Newest Incentive*, Contract Management, Feb 2001, National Contract Management Association, 44.

¹⁶ Ibid, 45.

¹⁷ Air Force Audit Agency, *Management of Award Fee Provision in Installation Level Supply and Services Contracts*, Project 0046411, Washington DC, February 1991.

¹⁸ Air Force Audit Agency, *Award Fee Management on Commercial Activity Contracts*, Project 98064024, Washington DC, 27 March 2000.

¹⁹ See Federal Acquisition Regulation (FAR) 37.602-4.

Chapter Three

Official Reviews and Findings

Audit Reports

Despite the encouragement and recommendation of senior acquisition officials throughout government to make use of incentives, particularly award fees, a challenge lies in using them correctly. Numerous studies and audits by Air Force Agencies have been accomplished to review how well the acquisition community has done in implementing the award fee concept. Occasionally the decision to use award fees is questioned, but in most cases the manner in which the contracts were implemented is the focus of the review.

Titan IV Audit

In 1995 the Air Force Audit Agency (AFAA) conducted an audit of the Titan IV production contract incentive and award fee program. Their intent was to determine if program office personnel effectively structured and administered the multiple incentive contracts to motivate the contractor to achieve all program objectives. Though this audit covered numerous areas, this paper highlights just the award fee portion of the audit.

The general conclusion of the audit was that Titan IV program office personnel did not effectively structure the production contract incentive and award fee program or develop adequate procedures for evaluating and administering contractor incentive payments.

Specifically with respect to award fees, personnel did not adequately evaluate contractor performance based on the award fee plan criteria. As a result, contractor performance ratings were not supported and fees awarded were not commensurate with actual performance.¹

The Titan IV production contract included an \$85 million award fee provision (pool) to motivate the contractor to achieve increased management, schedule, technical, and launch performance. The Audit team determined that the contractor's performance was not adequately evaluated in accordance with the award fee plan. Therefore performance ratings recommended to the Award Fee Review Board (ARB) were not supported and ARB award fee percentages recommended to the Fee Determining Official (FDO) were not commensurate with actual contractor performance. The following are summaries of specific findings:

1. Evaluation monitor performance ratings did not provide comments with respect to key evaluation criteria or included specific examples that indicated the criteria were not satisfied. Further, monitor comments were too general to demonstrate whether the contractor complied with the criteria.
2. Between January 1990 and January 1995, the prime contractor experienced significant cost increases due primarily to subcontractor cost overruns in the solid rocket motor (SRM) effort and schedule delay of 5 years and 2 years in the motor upgrade and other programs. However, the ARB recommended management effectiveness and schedule performance ratings (submitted to the FDO) during this time period did not appear to consider contractor schedule performance in these areas. Moreover, the ARB recommended ratings for management and schedule performance that were higher than previous reviews. The audit team believed these should have been rated marginal at best and the contractor should have received LESS award fee.²

The above problems occurred because award fee evaluation monitors were not adequately trained in evaluation and documentation requirements, the evaluation criteria were ambiguous and difficult to apply, and the ARB used the award fee process to place more emphasis on technical performance than permitted under the award fee plan.

Experts from the Deputy Assistant Secretary of the Air Force for Acquisition's (SAF/AQC) staff concurred with the comments and instituted efforts to correct deficiencies in training and

application noted by the audit. To prevent future questionable fees, the program office implemented new training and documentation requirements.

Management of Award Fee Provisions in Installation Level Supply and Services Contracts

In February 1991, the AFSA released Project 0046411, which evaluated award fee contracts at installations throughout the Air Force. The overall objective of the audit was to determine whether the Air Force effectively used and administered award fee provisions in installation—level supply and services contracts. Specifically, the agency determined whether use of the award fee provisions was adequately justified, the contract provisions included appropriate award fee criteria, the evaluation and payment process was effective, and award fee funds were effectively managed. The team found that Air Force management of installation-level award fee contracts required significant improvements. Specifically the report found:

- a. Contracting officers included award fee provisions in contracts without determining that anticipated award fee benefits exceeded the cost of the fees and associated effort to administer the special contract provisions. As a result, the Air Force incurred at least \$1.7 million over the contractual life of the 17 contracts without determining and documenting whether commensurate monetary and non-monetary benefits would result. In many of the examined cases the audit team determined the costs far outweighed the benefits. At Maxwell AFB, a \$4.6 million contract included a \$40,000 per year award fee pool as an incentive. The calculated administrative costs to administer the contract amounted to \$152,000 annually, far above the \$40,000 in possible incentive.
- b. Contracting personnel did not apply an appropriate methodology to establish the award fee pool for 13 of the 17 contracts. In most cases no formula or standards were clearly used to establish the award fee amount. As a result, 4 of the 13 contracts examined included about \$830,000 in potential excess profits.
- c. One or more necessary award fee contract provisions were missing from 15 of the 17 contracts reviewed. Without these contract provisions, contracting officers were not adequately protecting the Government's interests and contractors were not certain what was required to earn the award fees. The Air Force paid award fees when contractor performance did not warrant the fees, and the Air Force was more susceptible to litigation because its legal rights were not contractually established.

d. For 13 of 17 contracts reviewed, contracting officers did not monitor the process for selecting performance evaluation team members to ensure only appropriate personnel were selected. As a result, 4 instances were noted where performance monitors had potential conflicts of interest including actually working part time for the contractor they were evaluating, and 12 instances where people for the organizations being served were excluded from the team.

e. The process for evaluating contractor performance was not effective for 15 of 17 contracts. As a result, the Air Force paid award fees for 11 contracts without adequate evidence the contractor earned the fees. This included \$94,000 paid for 6 of the 11 contracts even though the contractor did not meet minimum acceptable performance requirements. At four locations contractors were paid award fees for performing voluntary work that was not contractually required nor included in the award fee criteria. At one location fees were paid when a janitorial contractor worked on days they were not required to, and performed services in buildings not covered in the contract. The fee determining official did not adequately justify the award fee paid and used criteria that were deemed unacceptable.

f. Installation officials did not provide timely award fee payments to contractors, requiring an average of 60 days after the end of the evaluation period to issue payment. This delay in providing award fee payment was a potential demotivator for contractors.

g. Accounting and finance personnel did not properly record award fee funds as a contingent liability in accounting records for 15 of the 17 contracts. As a result, these officials prematurely recorded over \$2.9 million as obligations before the Government had any legal liability to pay the contractor.

Analysis of Operational Level Fixed Price Award Fee Contracts

In January 1992 the Air Force Logistics Management Agency (AFLMA) began a project to assist acquisition offices in overcoming the findings in the 1991 AFAA Audit Report. The agency was chosen because it published a Base Level Award Fee guide in 1988 to assist offices in implementing the “new tool” known as Award Fee contracts.

The AFLMA reviewed the audit report, and performed an independent analysis of the entire award fee process from contract solicitation through administration of award fee provisions.

Additionally, the AFLMA conducted interviews with using agency officials and contracting professionals to develop professional consensus.

They concluded that many of the award fee processes were broken and that in order to fix the system, a fundamental change in how base officials view award fee decision making was necessary. They stated that, “Contractors should have to earn award fee money through above and beyond performance during each evaluation period instead of base officials looking for reasons not to pay the contractor the entire award fee amount.”³ This finding indicates that the AFLMA determined FDOs were committing a common error by starting the contractor’s fee entitlement at 100% and making reductions based on performance rather than starting at zero and working up (as the FAR requires). The agency also concluded that bases needed structured guidance to standardize award fee procedures and that “under current processes there is a high likelihood the government is improperly spending money through unwarranted and unjustified award fee decisions.”

Award Fee Management on Commercial Activity Contracts

In March of 2000 the AFAA again released an audit on Award Fee contracts which highlighted continuing problems and a few new ones. Interestingly, the audit team was apparently unaware of the similar audit ten years before as they did not reference it in the prior audits section or in the body of the report. Therefore, the findings were certainly independent and show no bias toward confirming earlier findings.

The audit was conducted because of increased use and associated cost of award fee contracts. The overall objective was to determine whether Air Force personnel adequately managed award fees on commercial activity contracts. Specifically, the agency determined

whether award fee officials (a) established award fee provisions consistent with overall contract strategy, (b) adequately supported fees awarded, and (c) adequately managed award fee funds.

The team concluded that award fee officials could improve award fee management on commercial activity contracts. Although officials established provisions consistent with the overall contract strategy, they did not maintain adequate documentation supporting award fee determinations or accurately account for award fee funds.⁴

Award fee officials at five of ten locations researched did not maintain adequate documentation supporting award fee determinations. Specifically, performance monitors did not maintain adequate records supporting award fee recommendations, award fee review board members did not always document the results of award discussions, and FDOs did not adequately document rationale for award fee amounts that varied from review board recommendations. In at least two cases the FDO significantly increased the fee amounts without rationale. Supporting documentation is important to help ensure the government pays appropriate award fees, but is also critical if the contractor disputes the award fee determination.

Award fee officials at six of ten locations did not accurately account for award fee funds. Specifically, they did not commit funds to establish contingent liabilities for award fee amounts. Instead, they recorded the entire award fee amounts as obligations, or actual liabilities, when evaluation periods began. As a result, for Fiscal Years 1996 through 1998, award fee officials overstated funding obligations by \$1.9 million.

Due to the above findings the auditors made three recommendations to improve award fee management on future commercial activity contracts. They recommended the Air Force establish award fee guidance incorporating best practices and procedures, and rescind inaccurate award fee obligation guidance. Additionally, they recommended the issuance of a policy letter

instructing award fee officials to commit funds as contingent liabilities when evaluation periods begin. SAF/AQC concurred with the findings and tasked the AFLMA to develop an Air Force guide. They also issued a policy with finance coordination on obligation of award fee funds.

Problems Resolved?

Analysis of the above four audits indicates recurring problems with award fee contracts. In every instance the reviewers found that the performance monitors were not documenting or justifying their recommended award fee amounts to the FDO. Therefore there was no legitimate rationale for paying award fees to the contractors involved. While the fees may be justified, the lack of explicit rationale leads inquiring investigators to conclude fees are being paid for no good reason. Similarly, in three of the four studies (the AFAA audits) the FDO's were not explaining their rationale for granting the fees. In some cases they even overruled recommendations from the monitors and board members. Again, lack of documented rationale could lead one to conclude that the contractors did not earn the fee but were granted the fee anyway. This conclusion is further supported by the AFLMA study, which indicated that FDOs commonly begin deliberations at an inflated fee amount (100%) and deduct for shortfalls. While the FDOs may have good rationale for the fees provided, the rationale is usually not clear.

Additionally, all three audits reported some sort of discrepancy in financial calculations with respect to the fee pool amount. In both the 1991 and 2000 audits, the reports specifically highlighted that the funds should be tracked as contingent liabilities, not up front obligations. At the time of this report, it is clear the Air Force has adopted such a policy.

Notes

¹ Air Force Audit Agency, *Management of the Titan IV Contract Incentive and Award Fee Program*, Project 95064005, Washington DC, 1996.

² Ibid, 8.

³ Tom Robinson and Randy Ayers, “Analysis of Operational Level Fixed Price Award Fee Contracts,” Project Number LC922155, *Air Force Logistics Management Agency Letter Report*, , January 1993.

⁴ Air Force Audit Agency, *Award Fee Management on Commercial Activity Contracts*, Report 98064024, Washington DC, ii.

Chapter Four

Award Fee in Application

Concept

The purpose in applying the award fee incentive is to obtain better performance from the contractor than could logically be expected with other contractual arrangements. It provides a means of applying incentives in contracts where performance objectives cannot be expressed in advance by definite milestones, targets or goals susceptible to actual measurement of performance.¹

For contracts with an award fee incentive, the buying office establishes an Award Fee Plan that defines formal evaluation periods throughout the life of the contract. For each evaluation period, fee "pools" which may be earned in part or whole by the contractor are identified, as are the criteria, techniques, and data that will be used in the evaluation of the contractor's performance. During an evaluation period, data relative to a contractor's performance is collected by technical and business monitors as they interact with the contractor. This data and the monitor's evaluations are subsequently provided to an Award Review Board for further evaluation. Additionally, the contractor is invited and encouraged to submit self-assessments of performance for consideration by the review board during the formal evaluation process that occurs at the end of each evaluation period. The evaluation results and recommendations are documented by the board and given to the FDO.

Based on all inputs, and his own judgement, the FDO determines the portion of the available fee to be awarded. He then advises the contractor, in writing, of the fee decision and performance evaluation within 30 days after the end of the evaluation period. The fee decision and performance evaluation are subjective, unilateral, and until recently were not subject to the disputes clause of the contract.²

From the process just described it can be seen that the nature of the award fee concept allows the government to provide formalized periodic feedback to the contractor on how he is progressing. It also provides the government with an opportunity to make periodic thorough evaluations of progress, and cause corrective action in areas under evaluation if performance is not as expected. The subjective after-the-fact nature of the performance evaluation and fee determination process provides unique flexibility for its users.

Regulations

Early coverage of the Award Fee type contract was included in the Armed Services Procurement Regulation (ASPR) in the 1960s at the behest of senior government officials such as Robert S. McNamara. In 1962 the DoD promulgated new policies for the use of incentive contracts in the ASPR and published its first Incentive Contracting Guide.³ In 1969 the DoD and NASA jointly published a second edition, the *DoD/NASA Incentive Contracting Guide*. NASA has published several editions of award fee guides since then. As mentioned earlier, the Air Force published an award fee guide in 1988 through the AFLMA and in 1997 the Air Force Materiel Command published its own version of the award fee guide for use throughout its own command.

As far as coverage in the Federal Acquisition Regulation (FAR), there is general guidance but little prescriptive guidance. FAR Subpart 16.4, *Incentive Contracts*, states the government's

policy about contractual incentives, describes five standard contractual incentives, and provides guidance for their use. The full text is provided in Appendix A but it describes two classes of incentives: (1) predetermined, formula-type incentives and (2) award-fee incentives. However, most of the actual guidance has been published in unofficial guides or handbooks.

Although common in the Air Force for years the award fee incentives were not included in the FAR until publication of Federal Acquisition Circular (FAC) 90-46, in May 1997. FAR 16.404 (a) explains the Fixed Price Award Fee (FPAF) incentive as follows: “Award fee provisions may be used in fixed price contracts when the Government wishes to motivate a contractor and other incentives cannot be used because contractor performance cannot be measured objectively.” FAR 16.404 (a) requires that in FPAF incentive contracts, the parties must negotiate a fixed price that includes profit. This price is one that the government will pay if the contractor performs satisfactorily. The parties must also negotiate an award (bonus) and an award fee plan. FAR does not however, prescribe the contents of the award fee plan.

Although the FAR contains many passages about incentives in general, there is little award fee guidance and no Award Term guidance in the regulations. In fact the entire FPAF guidance from FAR and DoD and Air Force supplements is provided at Appendix A and takes up only two pages. The organizational structure and procedures associated with these incentives, the FDO, award fee board, and award fee plan, is not prescribed in the Federal Regulation except for the requirement to negotiate a fee plan for FPAF contracts. Therefore for almost all guidance, acquisition offices must turn to agency specific guidance such as the award fee guides published by NASA, AFMC, and AFLMA.

Fee Determination in Practice

In order to determine exactly how award fee contracts are being implemented and used in the Air Force a telephone survey was conducted with government Contracting Officers (COs) and FDOs as well as representatives from industry to collect their perspectives and opinions of award fee contracts and their impact. Eleven COs with award fee experience were interviewed from two separate commands, Air Education and Training Command (AETC) and Air Force Materiel Command (AFMC). These two commands represent the bulk of experience in Air Force award fee contracts as AETC uses them for contracted base support and/or aircraft maintenance at virtually every base, and AFMC supervises most of the major systems acquisition efforts in the Air Force. FDOs were interviewed from four separate bases. These officials were usually the senior officer on the base or in the wing and held at least the rank of Colonel. Eight members of industry who frequently bid on and currently hold award fee contracts were also interviewed. These members were either in charge of or closely aligned with the proposal writing teams and were very involved in actual performance of the contracts for which they competed. They also represent some of the largest companies in the defense industry as well as some moderate sized companies competing for government contracts.

In order to collect completely open, honest, and useful data, all participants were interviewed under the guarantee of non-attribution to themselves or their organization. This guarantee was necessary to ensure the most candid and descriptive answers possible. The open-ended prepared questions used to conduct the interviews are included in Appendix B. The analysis that follows represents the consensus of the consolidated answers received.

Industry Strategy

The industry respondents in this survey indicated that on average they had bid on five separate programs that contained award fees in the last three years. Additionally the average number of contracts the respondents were currently performing was three. These averages indicate the credibility of the industry personnel surveyed in that they have extensive experience in both bidding on and performing contracts with award fee provisions. When asked what the average earned award fee percentage was for their company the consensus was that it varied by agency and command. One respondent clearly indicated that NASA typically gave higher fees on average but that the Air Force was not far behind. The consensus average for the Air Force was between 88 and 90 percent. The respondents did note that they track this data pretty carefully and know what historical average is for each organization, MAJCOM, or agency. That information is used extensively in the proposal process.

When asked if award fees really do incentivize performance most agreed that they do to some extent. However, the consensus was that the mere granting of a “bonus” by the government does not in and of itself increase the performance significantly. Significant improvement is usually not seen unless the award fee is somehow shared with the employees. In other words, in those companies that share award fee sums (or some other inducement) with the employees for increased performance, a marked improvement is seen. If the award fee is not shared among the employees, the performance is only marginally effective if at all.

When asked if award fees constrain contractors in any way, the consensus from respondents was that the award fee does not constrain, but shifts resources. The proposals are manpower intensive for both bidding and the award fee boards. Typically the companies expend significant effort making their case to the board that they deserve the fee. This “show” adds cost in both

manpower and money to the bottom line of contractors. This in effect increases the costs of performance (which they account for in the original proposal) and takes manpower away from performing the actual work.

When asked if award fees cause him or her to alter proposal strategy, every respondent unequivocally answered yes. The consensus was that it is inherent in proposal writing to account for the fee at least partially in structuring their proposal. When asked the follow up question, “Do you plan on 100 percent of the fee?” all answered no. However, they all did say they count on a portion of the fee based on their assumptions and detailed analysis and calculations from historical analysis. Rarely did history prove they could count on 100% of the fee. However, all respondents confirmed that this lowered their profit margins in the initial proposal and did increase their risk somewhat in the early stages of the contract. However, most believed the risk was no greater than moderate because they had never been denied a substantial portion of the fee. All agreed that if the FDO granted them little or no fee they would then be in a high-risk position, but again expressed that this almost never happens.

And finally, when asked if they found themselves performing work under award fee contracts that they would not normally perform if the contract were structured differently, a majority of the respondents answered “yes.” The consensus was that they were more likely to do extra things to keep the board members and the FDO happy. This could include tasks that if performed under a fixed price contract, would result in a claim.

Government Perspective

When government Contracting Officers (CCOs) were asked the average number of contracts with award fees they are currently working on, the responses varied from one to five but the average was two. In none of the cases did the respondents indicate this was their first award fee

contract. Therefore, similar to the industry representatives, the COs were seemingly well experienced in award fee execution and administration, while the FDOs were not. Two of the four FDOs were on their first award fee contract and none were serving as FDO on more than two. Despite little experience, all felt comfortable in the role and competent to perform as FDO. When asked what the average percentage of fee earned by their contractors was, the consensus among COs and FDOs was about 90 percent. All respondents indicated a range from 85 and 90.

When asked if the award fee provisions in contracts improve contractor performance all respondents, COs and FDOs alike, responded “yes.” The consensus was that award fee incentives are great. They create a partnership-like environment and inspire innovation in contractors, which leads to more efficiency. Additionally, they believed that employees genuinely worked harder to gain the incentive. As a corollary to this question the respondents were asked if the extra effort and administrative burden on the government’s part was worth it and all replied “yes,” even though they recognized the additional effort was quite extensive. The government representatives perceived a great improvement in performance and therefore determined that the improved performance was worth the extra effort.

All respondents were asked if they knew or believed that when determining award fee amounts the contractor’s profit in the original proposal is considered. The two groups of officials differed here as FDOs indicated that it was not a factor in their decision, and that in most cases they are unaware of the profit on the original proposal. The COs however had a perception that it was in fact a consideration, both among the board and the FDO. The consensus among COs was that even if it was not directly addressed, the FDOs were certainly aware of the original profit margin proposed either by direct personal evaluation or by fee “lobbying” by the contractors. They believe FDOs want to ensure contractors remain “healthy” and perform.

Both groups of government officials were asked if during fee determination the board and FDO tend to start from zero percent and work up or start from 100% and work down. The typical CO response to this question was “Are you asking what we should do, or what we actually do?” That response summarizes the common view among the contracting community in general and certainly among the respondents, that fees are usually worked from 100% down. COs believe the FDO starts out wanting to give the maximum fee and then finds reasons to deduct from 100% for things not done well, instead of justifying why the contractor should get any increment of the fee at all. Interestingly enough, the FDOs responses did not fully support this but did not disavow it either. The FDO consensus was that they usually start from the board recommendation amount and work from there. However, one FDO did indicate a bias toward higher amounts by focusing on the negative performance indicators rather than the positive ones. Given that this FDO’s award amounts fell into the same range as the others it can be reasoned that he sets an amount and subtracts for performance rather than justifying any fee at all.

Finally, the Contracting Officers were asked if award fees cause contractors to increase risk by lowering profit margins. Every CO answered that they believed that risk was increased due to contractors shaving initial profits in proposals. COs believe that contractors have now begun to count on the award fees as their total profit, and therefore are bidding tremendously low profit margins to stay competitive and win the business. They believed (like the contractors) that this effect is translated into moderate risk for the contractors. However, none of the COs could provide data showing that the increased risk is detrimental. When asked if any of their award fee contracts failed, they all said “no,” indicating the increased risk phenomena took no casualties.

Notes

¹ Department of Defense, Armed Services Procurement Regulation (ASPR) 3-405.5. Washington: Government Printing Office, 1 October 1975.

² Prior to 1997, award fee provisions stated that determinations were at the unilateral discretion of the government and were excluded from the process governed by the Contract Disputes Act. However, on 25 February 1997, the U.S. Court of Appeals, in *Burnside-Ott v. Dalton*, ruled that award fee determinations could not be excluded from normal dispute procedures.

³ Vernon Edwards, *Award Term Contracting A New Approach for Incentivizing Performance*, National Contract Management Agency, Fast Response Course Book, Vienna Va.

Chapter Five

Conclusion and Summary

Review of the Data collected during this research has illuminated numerous problems with award fee contracts. The conclusions associated with research are mixed however, when compared with the research question posed. Indeed, it appears there are genuine disconnects in the implementation and administration of award fee contracts, and those disconnects prevent the contracts from working as originally intended. However, the deleterious effects of the broken process are not as grave as one might imagine. The question of whether changes are necessary to improve the effectiveness of this contract tool is the difficult one. The research clearly indicates changes are necessary, but in most cases it appears changes or improvements would improve efficiency, not necessarily effectiveness. The findings and conclusions that follow will elaborate.

Summary of Findings

Analysis of the data provided and the background research conducted resulted in the following findings:

1. Audits from 1991 to 2000 and Air Force Agency studies revealed the consistent and repetitive problem of supporting the award fees given to contractors. Problems were cited with both the PM's and the FDO's ability to justify the award fees paid for better than average

performance. In many cases the key finding was inadequate documentation to support the fee, but whether or not the fee was justified could not be ascertained.

2. Application of award fee criteria is not being used as intended. Program Managers and FDOs were cited throughout audit reports for using evaluation standards inconsistent with original plans. In one audit the FDOs were seemingly making arbitrary increases and decreases in recommended amounts with no justification.

3. Contractors are performing services not required by the contract in order to gain favor with the award fee officials. This was not the intent of the incentive. The incentive was designed to encourage above average performance of the *assigned* tasks. This was supported by audit 0046411 and interviews with industry personnel

4. A perception exists that FDOs apply award fees incorrectly. Many in the acquisition community believe that they start the fee process at 100% and find reasons to deduct percentages rather than starting at zero and justifying any award fee given. This view was supported by the 1991 AFLMA study and current interviews with acquisition professionals.

5. There is significant variation in applying this tool. The contractors interviewed indicated they are aware of and track trends by organization and tailor their proposal strategies to account for historical trends. It is clear that there is no consistency even within the Air Force.

6. A disconnect exists in the perception of the value of award fees. Industry indicated that award fees mean little unless they take proactive measures to share the award with employees. They also believe they make the same profit whether or not the award fee exists. If it is not there, they bid higher initially. If it is there, they bid lower and make up the profit in the award fee. The government believes the incentive works as advertised despite the above insight from industry. The reason for this belief is most likely training and advertising. Government training

explains that incentives motivate contractors and therefore it is believed without challenge until proven otherwise.

7. Finally, award fees do indeed incentivize the wrong behavior and increase risk. Evidence from personal interviews of industry and government indicates that contractors bid extremely low profit margins to be competitive and win the business. They then absolutely count on receiving the award fee amounts as their profit. By using the award fee as the profit margin, that price is not factored into the evaluated proposal price and therefore the contractors remove their profit from the price evaluation. This strategy is very close to “buying in,” a term despised by government acquisition personnel. It is agreed by both the government and contractor that this does moderately increase risk to the contractor, especially in the first term of performance before award fees can be granted. However, there is no evidence to show that the increased risk has indeed impacted industry or caused the contractors to fail in their performance because of low initial profit.

Principle Conclusions

The conclusions of this study are based on the research question. This study examined three issues. Are award fee contracts implemented as intended? Are changes necessary to improve effectiveness? And are we incentivizing the wrong behavior and thereby causing detrimental effects?

To answer the first question, award fee contracts are not implemented as intended as the findings clearly show. The same problems are being experienced now as ten years ago as evidenced by the reviews. These problems however are procedural in nature and can be easily fixed.

The answer to the second question therefore, is yes improvements are needed, but they won't impact effectiveness, only efficiency. As the audits and studies show, guidance is needed for the Air Force community on how to properly implement award fee contracts. However, based on the nature of the findings it appears the Air Force has been directing its guidance to the wrong audience. The guidance is usually produced from the contracting community for the contracting community. However, the repetitive problems identified rest with the PMs and FDOs. Therefore any guidance produced to help the process should be directed toward them.

Finally, in response to the incorrect incentive and its detriment, the answer is split also. It is clear from the data gathered from industry and government sources that we are indeed incentivizing contractors to bid near zero profit and therefore increase the risk. However, the effects of that issue are not detrimental, as might be expected, for two reasons. First, the process to award this type of contract is usually complex and uses best value approaches, which enable the government to consider lots of quality indicators. Therefore, the contractors typically selected are quite solid and less prone to failure in the first place. They are quality contractors, therefore the increase in risk is mitigated by the quality of company. Second, the award fee process, by its nature, allows the contractor to gain additional funds throughout the contract and the government evaluation team is likely to "help" a contractor in order to maintain consistency of service. This built in dynamic also mitigates the risk to contractors by providing a mechanism to lessen the contractors exposure to risk throughout the contract.

The research supported the contention that the Air Force is not implementing award fee contracts as intended, and is in fact incentivizing the wrong behaviors in industry. However, the result is not extraordinarily detrimental to Air Force goals because of the inherent ability of the

award fee board to overcome additional risk. It is clear that improvements are necessary, but the gains will be in efficiency, not in effectiveness.

Implications of Study

This study was conducted in the midst of an ongoing review of award fee contracts and an effort by the AFLMA to develop more guidance for Air Force contracting offices to assist in award fee implementation. The findings contained in this document hopefully will direct the guidance writers to the correct target audience for maximum effect, the PMs and FDOs.

Recommendations

1. The Air Force should develop and distribute a standardized format and template for Performance Monitors and Fee Determining Officials to use when documenting their support of the fees awarded.
2. Training initiatives should be redirected. The bulk of the findings and conclusions in this report and others indicate there is a greater need for training and assistance for non-contracting personnel (Performance Monitors and Fee Determining Officials). The next product (guide or training course) developed should be targeted at them specifically and cover topics outlined in the findings section of this paper.
3. Contracting Officers should seek feedback from industry before including fee or term incentives in future contracts. The value of incentives can be overestimated by government personnel causing great administrative burden and little return.

Appendix A

Federal Acquisition Regulation Text

FAR 16.401, *General*, states,

(a) Incentive contracts as described in this subpart are appropriate when a firm-fixed-price contract is not appropriate and the required supplies or services can be acquired at lower costs and, in certain instances, with improved delivery or technical performance, by relating the amount of profit or fee payable under the contract to the contractor's performance. Incentive contracts are designed to obtain specific acquisition objectives by –

- (1) Establishing reasonable and attainable targets that are clearly communicated to the contractor; and
- (2) Including appropriate incentive arrangements designed to (i) motivate contractor efforts that might not otherwise be emphasized; and
(ii) discourage contractor inefficiency and waste.

(b) When predetermined, formula-type incentives on technical performance or delivery are included, increases in profit or fee are provided only for achievement that surpasses the targets, and decreases are provided for to the extent that such targets are not met. The incentive increases or decreases are applied to performance targets rather than minimum performance requirements.

(c) The two basic categories of incentive contracts are fixed-price incentive contracts (see 16.403 and 16.404) and cost-reimbursement incentive contracts (see 16.405). Since it is usually to the Government's advantage for the contractor to assume substantial cost responsibility and an appropriate share of the cost risk, fixed-price incentive contracts are preferred when contract costs and performance requirements are reasonably certain. Cost-reimbursement incentive contracts are subject to the overall limitations in 16.301 that apply to all cost-reimbursement contracts.

(d) Award-fee contracts are a type of incentive Contract

Text of AFFAR 5316.401-90 General.

(a) While the Government is solely responsible for determining the **award fee** to be paid, contractors shall be afforded appropriate opportunity to participate in the Government's award fee decision/determination process. The contractor's role in the Government's pre-decisional process may include, but is not limited to:

- (1) An opportunity to review and comment on written evaluations;
- (2) an opportunity to present contractor views on performance and on the amount of fee the contractor believes it has earned based on that performance; or

(3) an opportunity to attend as the Fee Determining Official (FDO) is briefed by evaluators and present comments on the evaluation but not to participate in the final decision making/determination by the FDO.

Text of FAR 16.404 Fixed-price contracts with award fees.

(a) Award-fee provisions may be used in fixed-price contracts when the Government wishes to motivate a contractor and other incentives cannot be used because contractor performance cannot be measured objectively. Such contracts shall-

(1) Establish a fixed price (including normal profit) for the effort. This price will be paid for satisfactory contract performance. Award fee earned (if any) will be paid in addition to that fixed price; and

(2) Provide for periodic evaluation of the contractor's performance against an award-fee plan.

(b) A solicitation contemplating award of a fixed-price contract with award fee shall not be issued unless the following conditions exist:

(1) The administrative costs of conducting award-fee evaluations are not expected to exceed the expected benefits;

(2) Procedures have been established for conducting the award-fee evaluation;

(3) The award-fee board has been established; and

(4) An individual above the level of the contracting officer approved the fixed-price-award-fee incentive.

Text of DFAR 216.404 Fixed-price contracts with award fees.

Award-fee provisions may be used in fixed-price contracts as provided in 216.470.

Text of DFAR 216.470 Other applications of award fees.

The "award amount" portion of the fee may be used in other types of contracts under the following conditions-

(1) The Government wishes to motivate and reward a contractor for management performance in areas which cannot be measured objectively and where normal incentive provisions cannot be used. For example, logistics support, quality, timeliness, ingenuity, and cost effectiveness are areas under the control of management, which may be susceptible only to subjective measurement and evaluation.

(2) The "base fee" (fixed amount portion) is not used.

(3) The chief of the contracting office approves the use of the "award amount."

(4) An award review board and procedures are established for conduct of the evaluation.

(5) The administrative costs of evaluation do not exceed the expected benefits.

Appendix B

Research Questionnaire

Questions asked of Industry

1. How many Award Fee contracts would you say your company has bid on in the last three years?
2. How many contracts are you currently performing that have award fee provisions
3. What is the average award fee percentage earned?
4. Do you feel award fees improve your company's performance?
5. Do Award Fee provisions constrain you in any way?
6. Do award fee contracts cause you to alter your proposal strategy or increase your risk?
7. When planning for contract proposal do you count on earning 100% of the fee
8. Do you find yourself performing tasks in award fee contracts that you would not normally perform if the provision was not there?

Questions Asked of Contracting Officers and Fee Determining Officials

1. How many award fee contracts would you say you are currently administering?
2. What is the average percentage earned by the contractor
3. Do you believe the award fee provision improves the contractor's performance?
4. Are the administrative burdens of the fee process worth the effort?
5. When determining award fees, do you consider the contractor's original profit margin?
6. In practice, do you tend to start from 0 percent and work up, or start from 100% and work down?

Questions Asked of Contracting Officers Only

1. Do award fees increase contractor's risk by lowering proposal profit margins?

Glossary

Award Fee Review Board. The award fee review board (sometimes referred to as the performance evaluation board) is an independent group of individuals who review contractor performance. Members are typically management personnel who receive direct benefit from the contract, but are independent from the contract award and administration process. Award fee review boards are typically comprised of three to five voting members and at least three non-voting members (i.e., legal representative, contracting officer, and functional organization chief). At the end of each evaluation period, both performance monitors and a contractor representative may present a performance evaluation summary to the board. Based on these presentations, the board members evaluate the contractor's performance, determine a recommended award fee amount, document the results of their discussions, and present their recommendation to the fee determining official.

Contracting Officer (CO). The contracting officer is involved in all phases of the evaluation process. First, the contracting officer organizes and coordinates the appointment of PMs, PEB members, and the FDO. The contracting officer must ensure that each team member understands the importance of his/her role in the overall evaluation process and is trained on the evaluation criteria. Second, the contracting officer serves as a technical advisor on the PEB. Finally, once the FDO approves an award fee, the contracting officer executes a contract modification to obligate the funds, and ensures accounting and finance officials expedite payment to the contractor.

Contractor Performance Evaluation. The Air Force provides award fees in installation—level contracts to motivate contractors to strive for a higher level of performance. Contracts with award fee provisions normally stipulate that designated Government personnel will subjectively determine the contractor's earned fee on the basis of periodic, after the-fact evaluations of the contractor's performance. The award fee determination process includes checks and balances that protect both the Government and the contractor from arbitrary or capricious evaluations. It is extremely important that Government officials maintain the integrity of the process for monitoring and reporting contractor performance.

Cost Plus Contract

Contract where the contractor is guaranteed reimbursement for all allowable and properly allocable costs incurred in performance of the contract. In the most frequently used variant the contractor is also paid a fee (which does not change regardless of the costs incurred).

Fee Determining Official (FDO) The fee determining official is the final decision authority in the evaluation process and is normally in a high-level position such as wing commander. The fee determining official becomes involved in the evaluation process only after the

award fee review board has agreed on a recommended award fee amount. If the fee determining official's final decision varies either upward or downward from the board's recommendation, the rationale for the change should be documented and explained with reference to the award fee plan. After the award fee determination is complete, the fee determining official sends a letter to the contractor announcing the fee earned and identifying the contractor's strengths and weaknesses (improvement areas).

Fixed Price Contract

In this type of contract, the Government and the contractor agree on a fixed price (or lump sum, as it is sometimes called) for timely delivery of an end-item or defined service in accordance with a specification.

Performance Monitor (PM). The performance evaluation process begins with the performance monitors (or quality assurance evaluators). Although the number of performance monitors depends on contract size and complexity, multiple monitors help ensure the contractor receives a comprehensive evaluation. Performance monitors are responsible for observing the contractor's day-to-day performance, documenting the contractor's performance throughout the period, and providing continuous feedback to the contractor. At the end of an evaluation period, performance monitors present contractor performance information and an award fee recommendation to the award fee review board.

Performance Evaluation Process. The performance evaluation process involves several team members including performance monitors (PMs), performance evaluation board (PEB) members, a fee determining official (FDO), and the contracting officer.

Performance Evaluation Board (PEB). The PEB is an independent group of individuals that reviews the contractor's performance and recommends the amount of award fee. PEBs are typically comprised of three to five voting members appointed by the FDO. Ideally, PEB members are management personnel who receive direct benefit from the contract, yet are essentially independent from the contract award and administration process. The PEB should also include a minimum of three non-voting members (i.e., legal officer, installation-level contracting officer, and chief of the functional organization responsible for the service) to provide technical advice. At the end of the evaluation period, both the PMs and a contractor representative may present a performance evaluation summary to the PEB. Based on these presentations, the PEB's voting members subjectively evaluate the contractor's performance, determine a recommended award fee amount, and present their recommendation to the FDO.

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